Docket:	:	A.16-07-002
Exhibit Number	:	ORA - ____
Commissioner	:	M. Picker
Administrative Law Judge	:	S. Park
ORA Witness	:	Mukunda Dawadi

REPORT AND RECOMMENDATIONS ON RATE BASE AND SPECIAL REQUEST #12

Application 16-07-002

San Francisco, California
February 13, 2017

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MEMORANDUM

The requests and data presented by California American Water ("Cal Am") in Application ("A.") A.16-07-002 were examined in order to provide the Commission with recommendations that represent the interests of ratepayers for safe and reliable service at lowest cost. Suzie Rose is ORA's project lead for the proceeding. Richard Rauschmeier is ORA's oversight supervisor. Paul Angelopulo and Kerriann Sheppard are ORA's legal counsel.

Although every effort was made to comprehensively review, analyze and provide the Commission with recommendations on each ratemaking and policy aspect presented in the application, the absence from ORA's testimony of any particular issue does not necessarily constitute its endorsement or acceptance of the underlying request, methodology, or policy position related to that issue.

CHAPTER 1: RATE BASE

A. INTRODUCTION

This chapter presents ORA's review of and recommendations on California American Water Company's ("Cal Am") proposed rate base for test year ("TY") 2018 and 2019. Cal Am's calculation of rate base for 2020 will not be evaluated herein, as the rate base for 2020 is a formulaic calculation prescribed by the current Rate Case Plan.[1]

B. SUMMARY OF RECOMMENDATIONS

Differences between ORA's and Cal Am's estimates of rate base are primarily the result of different estimates of Utility Plant in Service, which is separately analyzed and addressed in other areas of ORA's direct testimony, and secondarily from ORA's updates and corrections in Cal Am's estimated construction work-in-process amount, material and supplies, and allowances for working cash, which are described in the Discussion Section below.

Based upon a detailed analysis of Cal Am's proposed rate base calculations, the following adjustments are necessary in determining rate base for TY 2018 and 2019:

- For the purpose of forecasting TY 2018 and 2019 Construction Work-In-Progress ("CWIP") amounts, the California Public Utilities Commission

[1] The Rate Case Plan states that all rate base items are subject to two test years and an attrition year, consistent with D.04-06-018 (Page A-19). Per footnote 6 on p. 15 of D.04-06-018, "the attrition allowance methodology provides for rate base additions in year 3 by adding the difference between test year 1 and test year 2 rate bases to the test year 2 rate base. Depreciation expense is handled in the same way."

("Commission") should remove any CWIP amount aged longer than one year from the total 2015 CWIP balance used for ratemaking purposes.

- In order to have an estimate that reflects the current operational process in the Ventura District, the Commission should correct Cal Am's estimation of Material and Supplies for TY 2018 and 2019 by removing Ventura District's 2011 and 2012 Inventory-Conversion amount.
- The Commission should correct Cal Am's proposed revenue collection lag days for all districts to 12.6 days, consistent with the average, actual revenue collection lag.

C. DISCUSSION

Rate base generally represents the value of property used in providing service, upon which utilities are permitted to earn their authorized rate of return.[2] Cal Am's rate base includes weighted average utility plant in service, material and supplies, an allowance for working cash related to both operational and lead lag - with deductions for weighted average accumulated depreciation reserve, contributions in aid of construction, customer advances for construction, unamortized advances and contributions, and accumulated deferred income tax liability.[3]

1) Weighted Average Utility Plant in Service

ORA's analysis and recommendations on Cal Am's property, plant, and equipment are discussed in the testimony of Justin Menda and Daphne Goldberg.

[2] Cal Am is currently authorized to earn a return of 8.41% which is comprised of 47% debt at a calculated cost of 6.63% and 53% shareholder equity at a calculated cost of 9.99% per Commission Decision ("D.") 12-07-009.

[3] Direct Testimony of Edward J. Grubb, A16, pp. 6-7 and RO Model workpapers (Excel files) provided to ORA.

This section analyzes Cal Am's method of calculating Weighted Average Utility Plant for TY 2018 and 2019 and presents ORA's recommendations for this calculation.

Cal Am estimates Weighted Average Utility Plant in Service for TY 2018 by adding weighted average of net additions of utility plant and net change in CWIP amounts onto the beginning balance of utility plant for 2018, which is the year-end utility plant balance from 2017. Net plant additions are calculated by deducting estimated plant retirements from estimated gross plant additions.[4]

Cal Am forecasts the ending balance of utility Plant for years 2016 through 2019 by adding the projected capital expenditures to the recorded balance of plants as of December 2015 and deducting annual plant retirements.[5]

The differences between Cal Am's proposal and ORA's recommendation for estimated weighted average plant in service for TY 2018 and 2019 are due to ORA's adjustment of the proposed plant and the removal of any project lasting longer than a year from the CWIP estimate used for ratemaking purposes. A detailed analysis of and recommendations for CWIP are presented in the subsequent section.

2) Construction Work-in-Progress

Cal Am uses its 2015 Construction Work-in-Progress ("CWIP") balance to estimate the CWIP amount to be included in rate base for TY 2018 and 2019. In order to more reasonably estimate a CWIP amount for ratemaking purposes, the Commission should remove from the CWIP account (balance as of December 31,

[4] Table 7.1 of "Exhibit A – Financial Information and Results of Operations" (Chapter 7 of each district) and Tab "Weighted Avg UPIS EXA Tbl 7.1" of View Files (Excel Workpapers) of Results of Operations Model provided by Cal Am.

[5] Direct Testimony of Edward J. Grubb, A18, p. 7.

2015) any projects lasting longer than a year. The following table details the capital amounts and duration of time those amounts have resided in Cal Am's CWIP accounts as of December 31, 2015:[6]

Table 1-A. Detail of Construction Work-In-Progress amounts as of December 31, 2015 (in $)

District Name	1 year	2 year	3 year	4 year	5 year	6 year	7 year	8 year	9 year	Total
San Diego	507,084				429,049					936,133
Monterey	1,399,883	26,862	5,219	643,106	1,774,559	32,358				3,881,987
Los Angeles	83,810		7,959	840,822	4,261	1,852,559				2,789,412
Ventura	714,317	1,053,923	1,805,911		2,583	1,240,582		682,866		5,500,181
Sacramento	246,101	2,082	176,480	231,025		4,944,334	3,745		53,728	5,657,494
Larkfield	893,404	2,885,037	21,334	8,503						3,808,278
Grand Total	3,844,600	3,967,904	2,016,902	1,723,456	2,210,452	8,069,832	3,745	682,866	53,728	22,573,486
	17.03%	17.58%	8.93%	7.63%	9.79%	35.75%	0.02%	3.03%	0.24%	100.00%

The above table shows that almost 83% of Cal Am's 2015 CWIP balance is comprised of projects lasting longer than one year. Cal Am's utilization of the recorded 2015 CWIP balance in forecasting TY 2018 and 2019 CWIP amount is unreasonable because utilizing a CWIP balance that has 83% of the total amount comprised of projects lasting more than one year requires ratepayers to fund a full rate of return on projects that are not used and useful, nor estimated to be used and useful, for up to nine years. This outcome is especially unreasonable in light of the policy implemented by this Commission which first allowed CWIP to be included in rate base.

The Commission's practice of allowing CWIP in rate base for water utilities began with a staff recommendation in May 11, 1982 (Staff's

[6] Data extracted from Cal Am's response to Data Request ORA A1607002 MD6-002 CWIP. Cal Am provided CWIP aging report as of December 31, 2015 in the response.

Memorandum on CWIP – included herein as Attachment 1).[7] Staff's recommendation was based on CWIP studies that showed water utilities' capital projects require on average four months to complete.[8] As cited in Staff's memorandum, the study also revealed that company-funded CWIP amounts carried over into a succeeding year represented about 0.4% of the total CWIP balance.[9] It is clear that allowing a CWIP forecast in rate base for California's water utilities was premised upon the short duration of most capital projects undertaken by water companies, and the very small percentage of a CWIP balance that extended into a succeeding year.

Similar to Cal Am's methodology, ORA estimates TY 2018 and 2019 CWIP using the 2015 CWIP balance; however, ORA removes CWIP amounts (as presented in Table 1-B below) that have persisted in the account longer than one year. ORA's recommendation corrects the problems created by using an aged CWIP balance for ratemaking purposes. First, ORA's recommendation alleviates the unnecessary ratepayer burden of funding a full rate of return on investments that are not used and useful, nor anticipated to be used and useful, for upwards of nine years. ORA's recommendation also comports with the Commission's rationale for allowing CWIP in rate base. ORA's adjustment of the aged CWIP reduces Cal Am's rate base by a total of $18,728,886 for TY 2018, as shown in the Table 1-B, below.

[7] San Jose Water Company and California Water Service, for example, capitalize interest during construction, consistent with United States Generally Accepted Accounting Principles.

[8] Commission Staff's May 11, 1982 Memorandum on "Policy for Including CWIP in Rate Base for Water Utilities", p. 1 (Summary Section).

[9] Ibid.

Table 1-B. CWIP amount aged more than one year in Rate Base as of December 31, 2015

District Name	Amount ($)
San Diego County District	429,049
Monterey County District	2,482,104
Los Angeles County District	2,705,602
Ventura County District	4,785,864
Sacramento District	5,411,393
Larkfield District	2,914,874
Total:	18,728,886

For the purpose of estimating TY 2018 and 2019 CWIP amounts for ratemaking purposes, the Commission should remove any CWIP amounts for projects lasting longer than a year from the recorded 2015 CWIP balance.

3) Material and Supplies ("M&S")

The Commission should correct Cal Am's estimation of Material and Supplies ("M&S") for TY 2018 by removing Ventura District's 2011 and 2012 Inventory-Conversion amount in order to have an estimate that reflects the current operational process in the Ventura District. Cal Am estimates M&S amounts for TY 2018 and 2019 by escalating a five-year average of escalated recorded M&S amounts from 2011 through 2015. The recorded M&S amounts in the Ventura District include an amount associated with a 2012 inventory-conversion. Cal Am clarified "Inventory–Conversion amount" as an amount recorded in an Inventory–Conversion account, which was used to transfer balances of Inventory-Chemicals and Inventory-Plant Materials from Cal Am's old accounting system (JDE) to its new system (SAP) in 2012.[10] In response to Q.1.b of data request ORA A.16-07-002 MD6-004, Cal Am states that in order to have an estimate that reflects the current operational process in Ventura for years 2016-2019, Ventura's Inventory-Conversion balance for years 2011 and 2012 should be made zero. Hence, as per

[10] Cal Am's response to data request ORA A.16-07-002 MD6-004, Q.1.a.

Cal Am's response, ORA removes Ventura District's allocation of M&S conversion amount from 2011 and 2012 in order to estimate TY 2018.[11] ORA's adjustment reduces Ventura District's rate base by $29,154.03 for TY 2018.

4) Working Cash, Lead Lag

Cal Am estimates allowance for working cash related to Lead or Lag ("Lead/Lag") by utilizing a Lead/Lag study of one year of receivables and expense data ending September 30, 2015.[12] In a Lead/Lag study, the lead or lag in the payment of expenses is compared to the lead or lag in receipt of revenues to ascertain the timing differences. A "lead" signifies that the receipt or payment of cash preceded the services to be rendered while a "lag" denotes that receipt or payment of cash followed the rendered services. Depending upon the source and timing of funds, an allowance for working cash can be either positive or negative. Positive working cash increases rate base and negative working cash decreases rate base.

Cal Am estimates lead-lag days for TY 2018 and 2019 for each rate making district by deducting revenue lag days from the weighted average expense lag days. In Cal Am's methodology, expense lead/lag days are estimated by counting the number of days between the midpoint of the service period (accrual period) and the date of payment. Cal Am estimates revenue lag days for each rate making district by calculating and adding together three distinct components: 1) service lag days; 2) billing lag days; and 3) collection lag days.[13]

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[11] See Attachment 2: Cal Am's response to Data Request ORA A.16-07-002 MD6-004, Q.1.b for Cal Am's detail response.

[12] Direct Testimony of Edward J Grubb, A41, p. 16.

[13] Direct Testimony of Edward J Grubb, A46, p. 17.

The service lag days is the average number of days from the current meter reading date to the previous meter reading date. Cal Am calculates the service lag days by utilizing the "midpoint of service period" method.[14] Billing lag days is the number of days between the date the meter was read and date the customer is billed. Cal Am calculates billing lag days by utilizing actual billing dates.[15] Collection lag days is the average number of days from the date that a customer is billed to the date that the Company receives payment from the customer. Cal Am calculates the collection lag days by utilizing a receivable method,[16] which is discussed in detail in the following section.

Differences between Cal Am's proposal and ORA's recommended allowance for working cash related to Lead/Lag are due to the differences of recommended expenses amounts, discussed in other ORA witness testimony, and ORA's recommendation of reducing collection lag days to reflect the actual, average revenue collection lag, discussed below.

5) Collection Lag Days

The Commission should adjust Cal Am's proposed collection lag days to 12.6 days for all districts because Cal Am's proposed collection lag days unreasonably suggests that on average, all ratepayers submit payment after the billing due date.

Cal Am uses a receivables method, also known as "ratio of accounts receivable to credit sales," for the estimation of collection lag days. This method has resulted generally in much higher collection lag days than the actual number of days provided to ratepayers to make payment following receipt of a bill. The

[14] Direct Testimony of Edward J Grubb, A47, p. 17.

[15] Direct Testimony of Edward J Grubb, A48, p. 17.

[16] Direct Testimony of Edward J Grubb, A49, pp. 17-18.

following table compares Cal Am's proposed collection lag days with the actual number of days provided to ratepayers to make payment:

Table 1-C. Comparison of Cal Am's Proposed Collection Lag and Payment Due Days after Billing Date

District	Collection Lag	Payment Due Days after Billing Date	Estimation > Billing Due Days
Monterey Main	31.43	22	9.43
Monterey Garrapata	31.43	22	9.43
Monterey Toro	16.14	22	-5.86
Monterey Wastewater	37.63	22	15.63
San Diego	25.67	22	3.67
Los Angeles	23.96	22	1.96
Larkfield	22.86	22	0.86
Sacramento	22.75	22	0.75
Ventura	21.09	22	-0.91

The above table shows that except in the Toro and Ventura districts, Cal Am's proposed collection lag days are much higher than the actual number of days given to ratepayers to make payment. Cal Am's proposed collection lag assumes that on average, all ratepayers within a given district will be delinquent in submitting payment, which is not a reasonable assumption. By proposing higher collection lag days, Cal Am is unreasonably increasing the allowance for working cash related to Lead/Lag. This artificially increases rate base by about $6.8 million, as shown in Table 1-E, and puts undue burden on ratepayers in paying rates that provide Cal Am an investor-return on an inflated rate base.

Since Cal Am uses a receivables method to determine collection lag days that results in a higher number of collection lag days than the total number of days that ratepayers have to make their payments, ORA asked Cal Am to provide payment dates associated with the data Cal Am used for the calculation of service

lag and billing lag.[17] ORA wanted to verify whether actual data (utilizing billing dates and payment dates) supports the collection lag days estimated by Cal Am. Cal Am objected to providing payment date details for all districts on the basis that providing the data was overly burdensome due to the time needed to gather the data. Cal Am, however, did provide data, including collection dates, for its Ventura District, and offered to provide collection data for other districts if such information is critical to ORA.[18]

ORA calculated collection lag days for the Ventura District by using the data that Cal Am provided, and found that the average collection lag for the Ventura District is actually 12.6 days – much lower than Cal Am's proposed collection lag days of 21.09 days in the GRC application. ORA utilizes this value of 12.6 days for collection lag for all other districts, as well, and recommends the Commission utilize the same because Cal Am did not provide data for all districts as ORA requested in discovery.

Utilizing 12.6 days for collection lag is reasonable because it is well-supported by the actual payment data that Cal Am provided during discovery. Additionally, logical assumptions support utilizing 12.6 days for collection lag. It is reasonable to assume that some ratepayers will pay their bills earlier and some later, but on average, collection lag days will fall somewhere between the billing date and payment due date. It is likely that collection lag days will approach an average of 11 days, which is the midpoint of the 22-day payment period ratepayers are given to pay their bills. Adopting a collection lag days value of 12.6 implies that, on average, payments will be received by Cal Am 12.6 days after customers

[17] Cal Am utilizes detail service dates and billing dates data ending September 30, 2015 in calculating both service lag and billing lag.

[18] Cal Am's response to Data Request ORA A.16-07-002 MD6-003. See Attachment 3 for details.

receive their bills. Therefore, the Commission should adjust Cal Am's proposed collection lag days for all districts to 12.6 days.

The following compares Cal Am's proposal with ORA's recommendations pertaining to collection lag days (Table 1-D) and working cash related to Lead/Lag (Table 1-E). ORA's recommendation of collection lag days reduces Cal Am's proposed rate base by approximately $6.8 million, as shown in the Table 1-E below.

Table 1-D. Collection Lag Proposed by ORA and Cal Am

District	Cal Am Proposed Collection Lag Days	ORA Proposed Collection Lag Days	Cal Am > ORA
Monterey Main	31.43	12.60	18.83
Monterey Garrapata	31.43	12.60	18.83
Monterey Toro	16.14	12.60	3.54
Monterey Wastewater	37.63	12.60	25.03
San Diego	25.67	12.60	13.07
Los Angeles	23.96	12.60	11.36
Larkfield	22.86	12.60	10.26
Sacramento	22.75	12.60	10.15
Ventura	21.09	12.60	8.49

Table 1-E. Working Cash, Lead/Lag (related to Collection Lag) in $

District	Cal Am Proposed	ORA Proposed	Cal Am > ORA
Monterey Main	3,746,500	1,505,100	2,241,400
Monterey Garrapata	12,000	6,100	5,900
Monterey Toro	22,400	17,100	5,300
Monterey Wastewater	312,400	74,500	237,900
San Diego	1,221,300	196,500	1,024,800
Los Angeles	(126,900)	(1,080,000)	953,100
Larkfield	106,100	28,400	77,700
Sacramento	2,016,200	560,100	1,456,100
Ventura	1,557,000	733,700	823,300
Total	**8,867,000**	**2,041,500**	**6,825,500**

6) Depreciation Reserve

Depreciation reserve is the total of all depreciation expenses that have accumulated over time. When calculating rate base, the depreciation reserve is deducted from gross prudent investments to avoid earning an additional return on funds that have been previously recovered through depreciation expenses.

Cal Am estimates the weighted average depreciation reserve amount for TY 2018 in each rate making district by adding the weighted average accrual amount in 2018 to the beginning balance of depreciation reserve.[19] The annual depreciation accruals are determined by using proposed depreciation rates for 2018.[20] Cal Am's proposed depreciation rates are developed by Alliance Consulting Group through a depreciation study.[21]

The differences between ORA's and Cal Am's forecast of depreciation reserve is the result of differences in forecasted Utility Plant in Service.

7) Contributions and Advances

Cal Am estimates Contributions and Advances amounts for TY 2018 by adjusting anticipated future changes in Advances and Contributions based on the historical trends for receipts and refunds.[22] ORA follows the same methodology as Cal Am does in estimating the average amount of Contributions in Aid of Construction and Advances for Construction. Any difference between ORA's and

[19] Table 8.1 "Exhibit A – Financial Information and Results of Operations" (Chapter 8 of each district) and Tab "Weighted Plnt Res EXA Tbl 8.1" of View Files (Excel Workpapers) of Results of Operations Model.

[20] Direct Testimony of Edward J Grubb, A12, p. 12.

[21] Direct Testimony of F. Mark Schubert, A80, p. 200.

[22] Direct Testimony of Edward J Grubb, A35, p. 14.

Cal Am's forecast of Contribution and Advances amount is as a result of differences in forecasted Utility Plant in Service.

8) Accumulated Deferred Taxes

Cal Am calculates future year-end deferred tax balances by adding current year estimated deferred taxes related to plant investment, taxable contributions, and taxable advances and deferred Investment Tax Credit ("ITC") to the beginning of year balances. The starting point for calculating the deferred taxes for rate base is the recorded balance from 2015.[23] ORA follows the same methodology as Cal Am does in calculating Accumulated Deferred Taxes. Any difference between ORA's and Cal Am's forecast of Accumulated Deferred Taxes (both federal and state) are the result of differences in forecasted Utility Plant in Service, and differences in estimating tax expenses, which are discussed in other ORA witness testimony.

D. CONCLUSION

Differences between Cal Am and ORA estimates of rate base are, primarily, due to differences in estimates of Utility Plant in Service, and, secondarily, due to ORA's recommendation in the estimation of CWIP amounts, material and supplies, and allowance of working cash related to Lead/Lag. First, the Commission should remove any Construction Work-In-Progress ("CWIP") amount longer than a year from the total 2015 CWIP balance when forecasting TY 2018 and 2019 CWIP for ratemaking purposes. Second, the Commission should correct Cal Am's estimation of Material and Supplies for TY 2018 and 2019 by removing Ventura District's 2011 and 2012 Inventory- Conversion amount in order to have an estimate that reflects the current operational process in the Ventura District. Third, Cal Am's collection lag should be adjusted to 12.6 days in

[23] Direct Testimony of Edward J Grubb, A13, p. 5.

order to calculate a more reasonable amount of working cash allowance related to Lead/Lag.

CHAPTER 2: SPECIAL REQUEST #12

A. INTRODUCTION

This chapter presents ORA's review of California American Water Company ("Cal Am")'s Special Request ("SR") #12 to modify its Tax Act Memorandum Account[24] (Memorandum Account related to Bonus Depreciation) in order to track the net revenue requirement increase and recover revenue increase amounts in the next general rate case ("GRC").[25]

B. SUMMARY OF RECOMMENDATIONS

The Commission should reject Cal Am's SR #12 because this request creates a situation where California ratepayers could have to subsidize losses from Cal Am's parent company and/or its affiliates. Furthermore, Cal Am's request is contrary to the Resolution L-411A which created the Tax Act Memorandum Account that Cal Am requests to modify, and which ORA recommends should be closed consistent with the Resolution L-411A's explicit sunset date.

C. DISCUSSION

1) Cal Am's Special Request #12

Cal Am is requesting to modify its one way "Tax Act Memorandum Account" to a balanced account (two way memorandum account) so that it can also track net revenue requirement increases if Cal Am is not taking bonus depreciation and recover any net revenue requirement increase in its next GRC.[26]

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[24] Cal Am identifies through its responses (1.a and 1.b) to data request ORA A.16-07-002 MD6-006 that Cal Am is requesting to modify its "Tax Act Memorandum Account," listed as account AP in its Preliminary Statements, CPUC Sheet No. 7790-W.

[25] Direct Testimony of Jeffrey Linam, A70 (p. 38) and A73 (pp. 40-41).

[26] Direct Testimony of Jeffrey Linam, A73, pp. 40-41.

In making this request, Cal Am also requests that the Tax Memorandum Account be extended through the current rate cycle.[27]

2) History of Memorandum Account related to Bonus Depreciation

Commission Resolution L-411A established a one-way memorandum account (related to bonus depreciation) in June 23, 2011 for regulated utilities that did not address the impacts of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("Tax Relief Act") in 2011 or 2012 test year GRC proceedings.[28] The resolution intended to track decreases in revenue requirements resulting from increases in deferred taxes and other direct changes in revenue requirements resulting from taking advantage of the Tax Relief Act. The resolution clearly spells out that this memorandum account will not be used to recover any net revenue requirement increases and will be terminated without any impact on rates if the account reflects a net revenue requirement increase at the end of the period covered by the memorandum account.[29]

Cal Am was authorized to establish a "Tax Act Memorandum Account," a memorandum account related to bonus depreciation, in Commission decision ("D.")15-04-007.[30]

3) The Commission should reject Cal Am's Special Request #12

The Commission should reject Cal Am's SR #12 for two reasons: (a) the request puts undue burden on California ratepayers in possibly subsidizing the

[27] Direct Testimony of Jeffrey Linam, A71, p. 40.

[28] Resolution No L-411A, pp. 1 and 5. The Resolution also authorizes utilities to use savings from the new tax law provision to invest in qualified properties.

[29] Resolution L-411A, Order No. 4, p. 18.

[30] D.15-04-007 approved a settlement agreement that contains a proposal to establish a memorandum account in line with the Commission Resolution L-411A.

effect of losses of Cal Am's parent company and/or affiliates, and (b) Cal Am's SR #12 is contrary to the explicit authorization of Resolution L-411A.

First, granting SR #12 puts undue burden on California ratepayers in possibly subsidizing losses of affiliates. A net increase in revenue requirements tracked in the "Tax Act Memorandum Account" would most probably be the result of cumulative effects from Cal Am's parent company, American Water, and/or its affiliates, as described in the next paragraph.

Cal Am's request SR #12 is to accommodate an increase in revenue requirement resulting from not taking bonus depreciation. Cal Am states in testimony that bonus depreciation will not be taken in a situation of permanent loss of tax deduction.[31] In response to ORA's data request 5.a. of "ORA A.16-07-002 MC8-009," Cal Am states, "the decision to take or not take bonus depreciation as currently decided depends on actual and forecasted results as known on the date of filing the consolidated groups tax return. The NPV of the tax benefits from claiming bonus offset by the loss or deferral of tax benefits that result from claiming bonus is the primary consideration."[32] Hence, the decision to not take bonus depreciation would likely be made if there is a net-operating loss ("NOL") and/or carryforward/carryback of NOL for tax purposes. Cal Am does not file taxes on a stand-alone basis but rather consolidated with parent & affiliates. Cal Am's Parent Company, American Water Works Company, files federal taxes on a consolidated basis. The result of cumulative effects from Cal Am's parent company, American Water, and/or its affiliates would most probably contribute to the NOL, and thereby a net increase in revenue requirements tracked in the "Tax Act Memorandum Account." Granting SR #12 would allow Cal Am to track increased revenue requirement for late recovery –which results from not

[31] Direct Testimony of Jeffrey Linam, A73, Pages 40-41.

[32] Cal Am's response is attached at the end of this section as Attachment 4.

taking bonus depreciation, due to having a NOL, which is the result of actions of affiliates. This would therefore require ratepayers to subsidize affiliate losses because Cal Am would not be able to take full advantage of all tax deductions/exemptions on a stand-alone basis.

Second, Cal Am's SR #12 is contrary to the explicit authority granted in Resolution L-411A. Resolution L-411A was adopted to establish a memorandum account related to bonus depreciation in order to track impacts of the Tax Relief Act (2010) on revenue requirement, specifically for the period until the utility files its next GRC.[33] The resolution clearly states that the memorandum account created by the Resolution should not be used to recover any net revenue requirement increases; instead, the memo account should be closed if the effect is a net revenue requirement increase.[34] The ultimate purpose of SR #12 is to recover revenue requirement increases and extend the life of the memorandum account beyond the next GRC after which the account was created and intended to sunset, which is contrary to Resolution L-411A.

For the reasons stated above, the Commission should not grant Cal Am's SR #12. Furthermore, as discussed in detail in the testimony of Roy Keowen, Cal Am's "Tax Act Memorandum Account" should be closed.[35]

If the Commission authorizes Cal Am to modify its existing Tax Act Memorandum Account in order to track bonus depreciation and other tax deductions that are not available as the result of filing consolidated tax returns, the Commission should also establish a separate memorandum account to track the federal tax amounts collected from Cal Am's ratepayers that are not actually paid

[33] Resolution L-411A, Ordering Paragraph #3.

[34] Resolution L-411A, Ordering Paragraph #4.

[35] Refer to the Testimony of Roy Keowen for details.

on a consolidated basis so that any unpaid yet collected federal tax amounts can be refunded to ratepayers.

D. CONCLUSION

The Commission should reject Cal Am's Special Request #12 because: (a) if the request is granted, California ratepayers will likely end up subsidizing any losses caused by Cal Am's parent company, American Water, and its affiliates; and (b) Cal Am's request is contrary to the explicit authority granted in Resolution L-411A. Furthermore, as discussed in the testimony of ORA's witness Roy Keowen, the Commission should close the Tax Act Memorandum Account.

If SR#12 is granted, the Commission should also establish a separate memorandum account to track federal tax amounts collected from ratepayers through rates so that any unpaid yet collected federal tax amounts can be refunded to ratepayers.

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Attachment 1: Commission Staff's May 11, 1982 Memorandum re. Policy for Including CWIP in Rate Base for Water Utilities

State of California

M E M O R A N D U M

Date : May 11, 1982
(For June 2 Conference)

To : THE COMMISSION

From : M. Abramson, Acting Director, Revenue Requirements Div.
W. R. Ahern, Director, Util. Div.
B. Barkovich, Director, Policy Div.

Subject: Policy for Including CWIP in Rate Base for Water Utilities

RECOMMENDATION: It is recommended that the current policy of including construction work in progress (CWIP) in rate base for water utilities be continued. This should not lead the Commission to endorse a similar policy for energy and telecommunications utilities where construction time often exceeds one year.

SUMMARY: Water utility construction projects require on the average about 4 months to complete. This is a considerably shorter period of time than comparable energy utilities. Approximately 69% of new construction is company funded. New construction approximates 6% of the total plant in service and the amount of company funded CWIP, carried into a succeeding year, is only about 0.4%. Thus the perceived disbenefits of CWIP for ratepayers of (1) reduction in utility risk and thus management efficiency, and (2) intertemporal equity shifts, are minimized for water utilities. The financial benefit of disallowing CWIP in rate base is very small, and would, in the long run, be reduced and made even smaller, by the offsetting revenue requirement increase associated with the interest charges.

DISCUSSION: There are nearly 400 water jurisdictions (companies and districts) under regulation. Because of the inherent difficulty of studying a large number of districts, it was decided that to analyze typical construction projects, a few districts would be chosen as representative of the many systems throughout California. The data came from eight water districts representing

five water companies (see below). The data is from 1980 company records. Our choice was based on readily available data and a desire to include districts of various sizes, water sources and geographical locations.

Name	No. of Customers	County
Asuza Valley Water	15,467	Los Angeles
California American Water		
Monterey	33,090	Monterey
California Water Service		
East Los Angeles	27,618	Los Angeles
Oroville	3,724	Butte
Selma	3,550	Fresno
South San Francisco	15,395	San Mateo
San Jose Water	187,195	Santa Clara
Southern California Water		
Calipatria - Niland	1,030	Imperial

Water Utility Construction

Water projects with significant construction periods fall into five major categories: 1) miscellaneous structures, 2) tanks and reservoirs, 3) transmission and distribution mains, 4) treatment facilities and 5) wells. Transmission and distribution mains represent the largest on-going construction projects. Treatment facilities are usually major projects but are infrequently constructed and as a result the dollar impact in any given year is minimal. The average construction time and project costs for 1980 as a percentage of total plant by categories are:

Category	Construction Time	% of Plant
Miscellaneous Structures	3.1 months	1.2%
Tanks and Reservoirs	6.2	.2
Trans. and Distribution Mains	3.9	4.0
Treatment Facilities	8.3	.5
Wells	2.5	.1

It should be noted that for each category of plant that: 1) the actual construction time is well under a year and 2) the relative cost when compared to total plant is small. The inference here is that the amount of CWIP carried over from one year to the next and the interest earned prior to placing the plant in service are both relatively small. These points are examined later in the discussion.

Plant additions as a percent of total plant averaged 6% for the eight districts. The amount of contributions-in-aid-of-construction as a percentage of plant additions was 9% and the amount of advances for construction represented 22% of plant additions. Therefore, on the average, the companies funded 69% of the plant additions for the year.

The amount of CWIP at year end as a percentage of total plant additions for the year averaged 10%. Viewed another way, the amount of CWIP at year end was about 0.6% of total plant. It is reasonable to assume that the percentage of year-end CWIP that is company funded would approximate the 69% mentioned previously for plant additions in general. Therefore, any company funded CWIP carry-over into a succeeding year would be about 0.4% (69%x 0.6% = 0.4% approx.) of total plant.

Small Water Utilities Compared to Large Water Utilities

Although this study focuses primarily on Class A water utilities, the results also apply to CWIP inclusion into rate base for the smaller Class B, C and D water utilities. This follows because the types of construction, discussed earlier, are the same for all classes of water utilities. However, the average time to complete construction projects for smaller water utilities would be less, because the projects are smaller. As previously discussed, CWIP carry-over into a succeeding year, the major concern for ratemaking, is minimal for Class A's and would be less for Class B's, C's and D's. A further consideration is the lack of sophistication of many of the smaller water utilities; the burden of adding interest to projects as they are being constructed (i.e., keeping AFUDC accounts), would overwhelm many of them. Therefore, it is concluded that this study applies equally well to all water utilities.

Water Utilities Compared With Energy Utilities

To put water utility CWIP in perspective a comparison with energy utility CWIP is useful. Based on 1980 recorded information for the three largest combination electric and gas utilities the most significant fact is that on the average, CWIP carried over from one year to the next approximates 37% of total plant. This compares with the previously mentioned 0.4% for water utilities. This large year to year carry-over for energy utilities is principally due to the tremendous costs and construction times for electric generation facilities. It is the source of widespread concern (and the basis for current Commission policy disallowing CWIP in rate base for other utilities) that placing CWIP in rate base both (1) reduces utility risk and therefore the incentive to minimize costs, and (2) creates intertemporal equity problems (i.e., current ratepayers pay for plant that benefits later ratepayers).

It is interesting to note that even with the large CWIP carry-over, the average plant additions as a percent of total plant for energy utilities is 7% versus the 6% for water. For the gas operations only, the CWIP carry-over approximates 1.7%, a figure more in line with that for water utilities. This similarity is as expected since both use similar plant such as pumping, storage and transmission facilities.

If the Commission continues to allow CWIP in rate base for water utilities it should make clear that this situation does not lead the Commission to endorse a similar policy for energy and telecommunications utilities.

Commission Policy on Water Utility CWIP

An exhaustive search of past Commission decisions on water utility CWIP in rate base yielded very little in the way of a guide on the subject. The few decisions that were found tended to support traditional thinking, which is based on the argument that the short construction times coupled with relatively small amounts in CWIP for most water construction projects does away with the need for interest during construction. Hence, water utility CWIP has and is being placed directly into rate base for ratemaking.

Although interest bearing CWIP is not allowed in the ratemaking rate base, California American Water Company, Citizen Utilities Company, CP National and Pacific Gas and Electric Company at times have booked interest for major construction projects. These projects were not considered for ratemaking until placed into service. Though all of these water utilities have been in for rate increases in the last 5 years, CWIP in rate base has not been an issue.

Impact of Denying CWIP

To determine the financial impact of denying CWIP in rate base, two recent rate decisions for California Water Service (Bear Gulch and Hermosa-Redondo) were analyzed. In water utility rate proceedings, rates are designed for 3 years (two test years and an attrition year). Because the analysis herein requires a full summary of earnings, only the two test years were analyzed. The attrition year was not examined because no forecast is made of its summary of earnings. However, the result in the attrition year should approximate that of the second test year. The assumptions used in the analysis were: simple interest at 10% per annum on all company funded construction projects, an average construction time of 4 months per project, and the amount of CWIP funded by the company is 69%.

In the Bear Gulch proceeding, D.93845, dated December 15, 1981, the Commission authorized amounts of $462,600 (or 9.6%) in 1982 and $268,400 (or 5.0%) in 1983. A recalculation of the adopted results, to reflect the denial of CWIP in rate base yields a reduction in gross revenue requirement of $43,600 (or 0.9%) in 1982 and $43,600 (or 0.8%) in 1983.

In the Hermosa-Redondo proceeding, D.820151, dated January 5, 1982, the Commission authorized amounts of $599,500 (or 12.4%) in 1982 and $207,700 (or 3.8%) in 1983. A recalculation of the adopted results to reflect the denial of CWIP in rate base yields a reduction in gross revenue requirements of $25,700 (or 0.5%) in 1982 and $21,800 (or 0.4%) in 1983.

In these two districts, the impact of removing CWIP from the rate base results in an insignificant reduction, less than 1%, in gross revenues for each of the two test years 1982 and 1983. It is understood that the results are unique to these districts. However, given the short duration of the typical water project and the dollar amounts actually financed by the utility it is reasonable to conclude that similar results would be obtained in most water jurisdictions.

One consideration which we cannot, at this time, give a hard figure for, is the long-term impact of the build-up in interest charges if CWIP is disallowed in rate base for ratemaking. This interest will definitely cause the rate base to be larger than it would be if CWIP is allowed. The revenue requirements for this increase in rate base would tend to reduce the already small benefit of disallowing CWIP in rate base.

WF:wp

Attachment 2: Cal Am's Response to Data Request ORA A.16-07-002 MD6-004, Q.1.b

California-American Water Company

APPLICATION NO. A.16-07-002
DATA REQUEST RESPONSE

Response Provided By:	**Bahman Pourtaherian**
Title:	**Financial Analyst IIB**
Address:	**California-American Water Company 4701 Beloit Drive, Sacramento, CA 95838**
ORA Request:	**ORA A.16-07-002 MD6-004**
Company Number:	**CAW-ORA A.16-07-002 MD6-004 Q001b**
Date Received:	**October 5, 2016**
Date Response Due:	**October 17, 2016**
Subject Area:	**M&S**

DATA REQUEST:

The following questions are related to MS Excel file "ALL_CH09_RB_WP_MS" of RO Model:

1. Refer to the tab "Y_REC M&S_WS1," Cells B135:I151 (Rows 135 to 151). The table shows that Inventory-Conversion amounts are recorded in 2011 and 2012 but there are no recorded amounts in 2013, 2014, and 2015.

    b. How were these Inventory Conversion amounts determined?

CAL-AM'S RESPONSE:

The Inventory – Conversion account was used to transfer balances of Inventory- Chemicals and Inventory- Plant Material from Cal Am's old system (JDE) to the new system (SAP) in 2012. Recorded amounts for years 2011 and 2012 in this account should be allocated over Inventory – Chemicals and Inventory- Plant Material.

Cal Am's Ventura district (1551) used to carry inventory – Plant Material balances until 2012, after which the district switched to purchasing materials on an ongoing basis. In order to have an estimate that reflects the current operational process in Ventura for years 2016-2019, Ventura's Inventory- Conversion balance for years 2011 and 2012 should turn to zero without going through allocation process.

To make the adjustment in the RO model, the allocation of the Inventory Conversion should be as follows: (File name: "ALL_CH09_RB_WP_MS", Tab name: "Adjust to REC M&S_WS2")

District #	District Name	Structure Name	Balance Dec 2011	Balance Dec 2012	Balance Dec 2013	Balance Dec 2014	Balance Dec 2015
1501	CAW Corporate	Inventory - Conversion	-	-	-	-	-
1530	San Diego County District	Inventory - Conversion	-	0.00	-	-	-
1540	Monterey County District	Inventory - Conversion	-	0.00	(0)	(0)	(0)
1542	Monterey Wastewater	Inventory - Conversion	-	-	-	-	-
1548	Monterey - Toro	Inventory - Conversion	-	-	-	-	-
1549	Monterey - Garrapata	Inventory - Conversion	-	-	-	-	-
1550	Los Angeles County District	Inventory - Conversion	-	0.00	0	0	0
1551	Ventura County District	Inventory - Conversion	-	-	-	-	-
1552	LA-Baldwin Hills	Inventory - Conversion	-	-	-	-	-
1553	LA-Duarte	Inventory - Conversion	-	-	-	-	-
1554	LA-San Marino	Inventory - Conversion	-	-	-	-	-
1555	Monterey - Ambler	Inventory - Conversion	-	-	-	-	-
1560	Sacramento District	Inventory - Conversion	-	(0.00)	(0)	(0)	(0)
1561	Larkfield District	Inventory - Conversion	-	0.00	0	0	0
0	0	Inventory - Conversion	-	-	-	-	-
0	0	Inventory - Conversion	-	-	-	-	-
END of CAW		End		End	End	End	
1530	San Diego County District		(142,734.50)	(10,757.42)			
1542	Monterey Wastewater		(21,862.12)	(27,466.82)			
1548	Monterey - Toro		(2,960.78)	(8,800.42)			
1551	Ventura County District		(55,766.75)	(75,105.31)			
1560	Sacramento District		(209,709.87)	(1,526.65)			
1561	Larkfield District		(7,475.64)	(303.50)			
1540	Monterey County District		(273,800.55)				
1550	Los Angeles County District		(95,371.86)				
End	End	End	End	End	End	End	End
Check/Tie Out Section		Sum	0.00	0.00	(0.00)	(0.00)	(0.00)
		Sum of the total yearly balance for M&S	0.00	0.00	(0.00)	(0.00)	(0.00)
			TRUE	False	TRUE	TRUE	TRUE

District #	District Name	Structure Name	Balance Dec 2011	Balance Dec 2012	Balance Dec 2013	Balance Dec 2014	Balance Dec 2015
1501	CAW Corporate	Inventory - Chemicals	-	-	-	-	-
1530	San Diego County District	Inventory - Chemicals	-	-	-	-	-
1540	Monterey County District	Inventory - Chemicals	71,751	56,663	62,425	52,752	49,299
1542	Monterey Wastewater	Inventory - Chemicals	21,862	54,956	37,283	26,900	39,295
1548	Monterey - Toro	Inventory - Chemicals	-	-	-	-	-
1549	Monterey - Garrapata	Inventory - Chemicals	-	-	-	-	-
1550	Los Angeles County District	Inventory - Chemicals	9,412	18,273	12,076	10,640	9,843
1551	Ventura County District	Inventory - Chemicals	-	-	-	-	-
1552	LA-Baldwin Hills	Inventory - Chemicals	-	-	-	-	-
1553	LA-Duarte	Inventory - Chemicals	-	-	-	-	-
1554	LA-San Marino	Inventory - Chemicals	-	-	-	-	-
1555	Monterey - Ambler	Inventory - Chemicals	-	-	-	-	-
1560	Sacramento District	Inventory - Chemicals	72,146	226,744	52,630	46,739	61,133
1561	Larkfield District	Inventory - Chemicals	2,685	11,854	2,586	1,602	3,615
0	0	Inventory - Chemicals	-	-	-	-	-
0	0	Inventory - Chemicals	-	-	-	-	-
END of CAW		End		End	End	End	
1540	Monterey County District		71,750.68				
1542	Monterey Wastewater		21,862.12	27,466.82			
1550	Los Angeles County District		9,412.13				
1560	Sacramento District		72,145.68	525.21			
1561	Larkfield District		2,684.61	108.99			
0							
End	End	End	End	End	End	End	End
Check/Tie Out Section		Sum	177,855.22	368,490.64	166,999.45	138,633.28	163,184.44
		Sum of the yearly balance	177,855.22	368,490.64	166,999.45	138,633.28	163,184.44
			TRUE	TRUE	TRUE	TRUE	TRUE

District #	District Name	Structure Name	Balance Dec 2011	Balance Dec 2012	Balance Dec 2013	Balance Dec 2014	Balance Dec 2015
1501	CAW Corporate	Inventory - Plant Material	-	-	-	-	-
1530	San Diego County District	Inventory - Plant Material	142,735	123,468	104,737	113,360	106,982
1540	Monterey County District	Inventory - Plant Material	202,050	179,208	175,788	196,390	171,532
1542	Monterey Wastewater	Inventory - Plant Material	-	-	-	-	-
1548	Monterey - Toro	Inventory - Plant Material	2,961	8,800	11,787	13,052	13,347
1549	Monterey - Garrapata	Inventory - Plant Material	-	-	-	-	-
1550	Los Angeles County District	Inventory - Plant Material	85,960	80,938	110,286	105,642	142,098
1551	Ventura County District	Inventory - Plant Material	-	-	-	-	-
1552	LA-Baldwin Hills	Inventory - Plant Material	-	-	-	-	-
1553	LA-Duarte	Inventory - Plant Material	-	-	-	-	-
1554	LA-San Marino	Inventory - Plant Material	-	-	-	-	-
1555	Monterey - Ambler	Inventory - Plant Material	-	-	-	-	-
1560	Sacramento District	Inventory - Plant Material	137,564	110,678	100,353	148,811	197,866
1561	Larkfield District	Inventory - Plant Material	4,791	4,482	4,615	3,522	3,522
0	0	Inventory - Plant Material	-	-	-	-	-
0	0	Inventory - Plant Material	-	-	-	-	-
END of CAW		End		End	End	End	
1530	San Diego County District		142,734.50	10,757.42			
1540	Monterey County District		202,049.87				
1548	Monterey - Toro		2,960.78	8,800.42			
1550	Los Angeles County District		85,959.73				
1560	Sacramento District		137,564.19	1,001.44			
1561	Larkfield District		4,791.03	194.51			
End	End	End	End	End	End	End	End
Check/Tie Out Section		Sum	576,060.10	507,575.45	507,566.59	580,776.37	635,347.04
		Sum of the total yearly balance for M&S	576,060.10	507,575.45	507,566.59	580,776.37	635,347.04
			TRUE	TRUE	TRUE	TRUE	TRUE

Attachment 3: Cal Am's Response to Data Request ORA A.16-07-002 MD6-003, Q.1.a.

California-American Water Company

APPLICATION NO. A.16-07-002
DATA REQUEST RESPONSE

Response Provided By:	**Edward J. Grubb**
Title:	**Regulatory Consultant**
Address:	**P. O. Box 23398, Belleville, IL 62226**
ORA Request:	**ORA A.16-07-002 MD6-003**
Company Number:	**CAW-ORA A.16-07-002 MD6-003 Q001a**
Date Received:	**September 27, 2016**
Date Response Due:	**October 6, 2016**
Subject Area:	**Lead Lag**

DATA REQUEST:

1. Provide customer payment dates for each of the rows in the Tab "Serv & Billing Lag" of the following MS Excel workpaper files:

   a. SDC_CH09_RB_WP_Lead Lag Support.xlsx

CAL-AM'S RESPONSE:

California American Water objects on the basis this Request is unduly burdensome because it seeks reporting that does not currently exist and the creation of which would require the gathering of extensive information, new calculations, and the generation of new work product. California American Water further objects on the basis the Company has already conducted a "lead lag" study calculating the payment lag using a standard based on widely accepted methods used by the accounting profession. It, therefore, appears this Request asks for extensive effort by the Company in order to provide information on a subject for which there is already an ample alternative source.

Furthermore, please see California American Water's response to MD6-003 Q1i for a detailed discussion of the process necessary to attempt to generate the information this Request seeks. In the spirit of cooperation and to ensure ORA received the information it needs, if ORA believes – despite the existence of the lead lag study and the extensive effort generating the information will require – the information sought in this Request is critical, please let us know. We will then try to work out a schedule to get it to ORA.

Attachment 4: Cal Am's Response to Data Request ORA A.16-07-002 MC8-009, Q.5.a.

California-American Water Company

APPLICATION NO. A.16-07-002
DATA REQUEST RESPONSE

Response Provided By:	**Jeffrey M. Dana**
Title:	**Vice President of Finance**
Address:	**California American Water** **655 W. Broadway, Suite 1410, San Diego, CA 92101**
ORA Request:	**ORA A.16-07-002 MC8-009**
Company Number:	**CAW-ORA A.16-07-002 MC8-009 Q003a**
Date Received:	**October 11, 2016**
Date Response Due:	**October 21, 2016**
Subject Area:	**Tax Act Memo Account**

DATA REQUEST:

1. Cal Am's response to ORA Data Request MC8-005 question 1.d states "California American Water must analyze each year whether it should elect bonus depreciation":

    a. Explain why Cal Am would choose NOT to take bonus depreciation in any given year.

CAL-AM'S RESPONSE:

The decision to take or not take bonus depreciation as currently decided depends on actual and forecasted results as known on the date of filing the consolidated groups tax return. The NPV of the tax benefits from claiming bonus offset by the loss or deferral of tax benefits that result from claiming bonus is the primary consideration.

Attachment 5: Witness Qualifications

QUALIFICATIONS AND PREPARED TESTIMONY OF MUKUNDA DAWADI

Q.1 Please state your name and business address.

A.1 My name is Mukunda Dawadi and my business address is 505 Van Ness Ave, California 94102.

Q.2 By whom are you employed and in what capacity?

A.2 I am a Public Utilities Financial Examiner III in the Communication and Water Policy Branch of the Office of Ratepayer Advocates ("ORA").

Q.3 Briefly describe your pertinent educational background.

A.3 I graduated from California State University, Los Angeles with a Master's of Science in Accountancy.

Q.4 Briefly describe your professional experience.

A.4 I joined Communications and Water Policy branch of ORA in January 2014 as an Auditor. I have worked on three general rate cases and have analyzed general office expenses, construction work in progress, affiliated transactions and revenue from non-tariffed products and services. I have also analyzed a debt issuance application and advice letter filings.

Q.5 What is your responsibility in this proceeding?

A.5 I am responsible for the testimony on Cal Am's Rate Base and Special Request #12, presented in this report.

Q.6 Does that conclude your direct testimony?

A.6 Yes, it does.